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¶1. (SBU) Drought Contributes to GOK Fiscal Woes; A Macro Update

Prime Minister Odinga and Finance Minister Kenyatta told a recent gathering of potential foreign investors that ongoing drought has created widespread food insecurity across Kenya. Both leaders characterized the food shortages as their "number one economic challenge," noting that (unforeseen) government expenditures to alleviate hunger and high maize prices are deepening the country's growing deficit (already roughly 5% of GDP). On corruption, Kenyatta blamed the Kenyan media for portraying the country in a negative light; he admonished the private sector for paying bribes and being "the flip side" of corruption. Kenyatta told visiting Treasury Acting A/S Andrew Baukol on March 9 something similar, arguing that "perceptions tend to dominate over reality" and that "sometimes the media overreacts" when it comes to issues of governance. Odinga defended his record on corruption, noting that he had never been implicated in a "major scandal," and that 12 investigations into malfeasance at parastatals had resulted in the removal of six CEOs. The two leaders attenuated investor concerns about Kenya's double-digit inflation by emphasizing that the current government methodology significantly overstates the CPI (reftel); inflation would fall to single digits this year, they said. (The IMF estimates an inflation rate of 10.5% by June 2009.)

Consistent with IMF estimates, Odinga and Kenyatta said they expected GDP growth of 3% in 2009 (Comment: we believe growth could be much closer to 2% in 2009 but even 3% is equivalent to zero per capita growth given Kenya's roughly 3% population growth rate). Kenya is on track to receive $100m (likely in the second quarter)

from the IMF's Exogenous Shock Facility (ESF) for balance of payments support. The IMF Mission to Kenya told us in early March that the ESF will come to the Board in April or early May. Still the GOK faces a Ksh 44 billion ($550m) in (as yet unidentified) expenditure cuts as it attempts to close a Ksh 72b budget gap ($900m); the government hopes a combination of domestic borrowing and donor assistance will make up the difference. Finance Minister Kenyatta told Acting A/S Andrew Baukol that cuts will be focused on infrastructure projects that have not yet started but that, for stimulus purposes, the GOK wants to retain as much capital spending as it can. There is no expectation among stakeholders that any of the Ksh 8 billion in planned privatization will occur this year.

¶2. (SBU) Shipping News from the Port of Mombasa

The Managing Director (MD) of the Kenya Ports Authority recently told us that the Port of Mombasa is "operating at optimal capacity." He said 24-7 ops and the utilization of satellite storage areas have reduced the number of stockpiled containers at the port to 6,400, down from over 14,000 through much of 2008. Ships typically hold at sea not longer than a few days; the exception being those carrying bulk maize which requires space in the silos at the port. The global economic slump and Somali pirates have not, as yet, made a discernable impact on the flow of trade into/out of the port, according to the MD.

A deep water port at Lamu is desirable, the MD said, to capture trade using the largest ships which the Port of Mombasa cannot accommodate due to its shallow and winding channels; a port in Lamu could also more efficiently deliver goods to/from southern Sudan and Ethiopia. China, Kuwait, and Qatar have all reportedly expressed interest in funding development of a port in Lamu. The MD welcomed a proposed visit by the U.S. Coast Guard in May 2009 to Mombasa to review compliance with the International Ship and Port Security Facility Code.

In a separate meeting, a private ship handling company told us that despite container decongestion, the port remained a difficult place to do business primarily due to inefficiencies at the Kenya Revenue Authority (KRA). According to the ship handler, KRA continues to resist full automation and greater transparency because of entrenched smuggling interests. The company also noted the deterioration of Kenyan rail (which hauled 8 million tons in 1960 and only 1 million in 2008) as a primary cause of constrained trade.

¶3. (SBU) Coastal Tourism in Decline

The Kenya Association of Hotel Keepers and Caterers reports a significant decline in tourism in recent months, which it attributes to the global economic slump. Hotel occupancy rates in the coastal region, traditionally popular with Europeans, are down to only 10%-15% (80%-90% is normal for this time of year) - a level worse than during the aftermath of 2008 ethnic violence. Normally, the coast receives some 60 charter flights per week from Europe; in recent weeks there have been only five. Despite the recession and incidences of Somali piracy, cruise ship traffic has remained steady, but the Association laments that passengers are especially transient and low-budget spenders. Child sex tourism continues to plague the coast, especially in private, unregulated villas in the Malindi area.

¶4. (SBU) Broadband Comes to Kenya

In June 2009, SEACOM (75% African owned, 25% international) reports it will "switch on" its submarine fiber optic cable, providing East Africa with its first broadband connection to the Internet. The $600m cable will deliver 1.28 tbs of bandwidth to enable HDTV, peer-to-peer networks, and other services requiring significant bandwidth. SEACOM says it will provide open access, low cost service to remain competitive and spark innovation - generating even greater demand for its cable; rival broadband connections are due in the near term.

¶5. (SBU) Anti-Money Laundering Legislation Still Stalled

During his March 9 meeting with Finance Minister Kenyatta, Acting Treasury A/S Andrew Baukol encouraged passage of Anti-Money

Laundering legislation ahead of the upcoming AGOA Forum as one sign that Kenya was on track. Kenyatta indicated that there had been considerable consultation and that the GOK was ready to take a number of amendments to the bill on board and "publish a new bill" when Parliament resumes April 21. Finance Ministry officials claimed they had made a significant push on the legislation at the end of the previous session. Some contacts told us that it would return in the next Parliament without having to start the legislative process again. That no longer appears to be the case. As we currently understand it, the bill will need to begin the process again when MPs return.

¶6. (U) Kenya Expands Geothermal Production

Vice President Kalonzo Musyoka gave the keynote address at the March 5 dedication of Olkaria III, a 35MW expansion of an existing 13MW geothermal facility (Olkaria II) near Lake Naivasha - the only privately owned and operated geothermal plant in sub-Saharan Africa. Ormat Technologies, based in Reno, Nevada, financed the $150 million project, which its chairman describes as the "largest private US investment in a single renewable energy project in Africa." (Note: Ormat is generally considered an Israeli company, headquartered in Nevada. However, much of the equipment used to outfit both Olkaria II and Olkaria III was bought from American companies.) On an annual basis, the expanded power plant will save Kenya an estimated 120,000 tons of imported oil and reduce carbon emissions by 200,000 tons. The cost of energy remains high in Kenya due to low hydro power output and the need to import fuel using a weakened shilling.

VP Musyoka declared that the grand coalition government recognizes that geothermal is "critical" to Kenya's power needs. He announced that it would devote KSh4.5 billion (about $60 million) towards the formation of a parastatal, the "Geothermal Development Company" (GDC), to undertake upstream activities, namely exploratory drilling. According to Energy Minister Kiraitu Murungi, who also spoke at the dedication, another parastatal, the Kenya Electricity Generating Company (KENGEN), will continue to conduct exploratory drilling in the Olkaria Domes, Eburru, and Menengal. Otherwise, the GDC will be henceforth responsible for drilling. Murungi contended Kenya has a geothermal potential of 7,000MW.

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